**Testimony before the**
**Michigan House of Representatives Committee on Commerce**

**RE: SB 298**
**Hearing Date: September 6, 2005**

I am Iris Linder, a corporate attorney from Fraser Trebilcock Davis & Dunlap, P.C. We are a Michigan law firm with offices in Lansing and Detroit. I am also on the Michigan Venture Capital Association ("MVCA") Legislative Committee. I apologize for not being available to the Committee in person, but I had a prior commitment that I cannot change.

The MVCA has strongly supported a legislative improvement of the franchise fee provisions of the Michigan Business Corporation Act. As currently written, the Michigan franchise fee requirement is somewhat unique in that one effectively "buys" shares of authorized stock, paying for each share of authorized stock at the time of authorization, but then has very modest ongoing annual filing fees. For the typical closely held corporation, the approach taken under Section 1062 of the Michigan Business Corporation Act is excellent. One can authorize 60,000 shares for a franchise fee of $50. In a typical closely held corporation, 60,000 shares is plenty.

However, when a company is receiving private equity investment from institutional investors and venture capital investors, those investors typically desire the company to have a very large number of authorized shares so that the price attributable to each share is quite low. In the typical venture capital investment context, the authorized shares would rarely be less than one million, and the first or second round of investment might be as high as 10 to 50 million authorized shares just depending on the financial structure of the entity and the size of the financing. The fact that this many shares is authorized does not mean that the company is large or profitable. Of course, large companies that are publicly traded and have access to substantial resources to pay corporate expenses also typically have very large numbers of shares authorized.

The problem with the Michigan Business Corporation Act as it is now written is that no distinction is drawn between those companies that have substantial assets and/or income compared to companies that have very little assets and/or income, but are seeking private equity investment. As now written, to authorize a million shares of stock, the franchise fee is $1,410. To authorize 10 million shares of stock, the franchise fee is $5,000. To authorize 50 million shares of stock, the franchise fee is $65,000. That is simply too high of an expense for an entity that has, in some cases, no revenue or employees yet, and in other cases, may be operating at a loss in the early stages of its development.

I have two illustrations of the problem from my practice in this year alone. One is a company that is being incubated in the Ann Arbor area using scientists from the University of Michigan. The founder, who was once affiliated with the University of Michigan, has now moved to Silicon Valley in California. The company is incorporated as a Delaware corporation, but is qualified to do business in Michigan since that is where the principal office is located. Under existing law, the corporation initially had to pay franchise fees on only 60,000 shares as a foreign corporation. However, next year when the annual report is due, the balance of the shares authorized will have to be paid for. At that time, when the company is evaluating whether to more formally set up shop in Michigan or move its research and development operations to

Palo Alto, it will have a $5,000 plus franchise fee bill if it stays in Michigan. Such a fee is obviously counterproductive to the goal of keeping the company located in Michigan. This is a company that will not be in a position to generate revenues for several years.

A second example is a company based in Traverse City. This company is a Nevada corporation doing business as a foreign corporation in Michigan. It originally had authorized 50 million shares of stock knowing that it was seeking private equity. When the bill from the State of Michigan came due for $60,000 or so, this company, which is just on the borderline of profitability, decided to reduce its authorized shares. The authorized shares in the state of Nevada cost very little, but the company did not want to leave Michigan as its home office, and therefore reduced the number of authorized shares to avoid the very large franchise fee that would otherwise be due. The ability of this company to grow and hire employees was limited by the difficulty it was having in accessing capital.

Subsequently, this company became engaged in merger negotiations with a Washington based company. In connection with the proposed merger, private equity was invested in both the Michigan based company and the Washington based company. When it came time to apportion the final investment amount between the two companies, the Michigan based company did not have enough authorized shares to accept the amounts otherwise allocated to it, due to its prior reduction of authorized shares. The institutional private equity investors did not want to wait for more shares to be authorized. As a result, a disproportionate amount of the financing was allocated to the Washington based company. It has been six months since this occurred, and the merger has still not closed. If the merger does ultimately close, all of the private equity investment money will come back to Michigan. However, in the meantime, that money has been sitting in a Washington bank, not available to the Michigan business to continue its growth and development. Furthermore, once the merger closes, the intention is that the Traverse City office will remain the principal office of the entity, and we will once again be faced with paying a very significant franchise fee for a company that is just beginning to grow and hopefully thrive.

As I hope that these two examples illustrate, the current franchise fee structure is very discouraging of keeping in Michigan companies that receive private equity or venture capital financing, unless they are so very large that the amount involved is not a significant portion of their budget.

I understand that a proposed compromise is being circulated that would address the problem in a different fashion than the way that it is handled in SB 298 as it passed the Senate. This proposal has a basic franchise fee structure of $50 for up to 60,000 authorized shares, $100 for up to 1,000,000 authorized shares, $300 for the next 4,000,000 shares, $500 for the next 5,000,000 shares, and $1,000 for each increment of 10,000,000 over the first 10,000,000 authorized shares. If I understand the proposal correctly, in the case of the second illustration, the franchise fee would have been in the ballpark of $5,000 as opposed to in excess of $60,000. This proposed reduction strikes me as reasonable. The very newest companies should be able to work in the 1- to 10-million-share range. More seasoned, but still developing companies should be able to add authorized shares as needed for capital infusions at a reasonable price.

I understand that as part of the proposed compromise, a new authorization for expedited service fees would be added to the Business Corporation Act. I also fully support this part of the proposed compromise. The proposal that I have seen is pretty consistent with what other states, such as Delaware, charge for an expedite fee. The existing Business Corporation Act does not have sufficient authorization for expedite fees. In 2004, due to an unexpected death and several simultaneous maternity leaves, the Corporations Division was unable to process requests for expedited filings for several months. I talked at length about this with Ann Baker, who is the head of the Corporations Division. I believe that she sought, but was not able to obtain, approval from her superiors to cover the expenses of overtime for the employees who were still available. At that time, I indicated to Ms. Baker my opinion that the business community would welcome a statutory change that allows the Corporations Division to charge more significant expedite fees. This gives a filer the opportunity to decide whether or not an expedited filing is worth the cost, while making sure that an expedited filing will be available for those who want to pay for it. Thus, the proposed compromise resolves another problem that existed in the Business Corporation Act.

I personally, and on behalf of the Michigan Venture Capital Association, strongly endorse the proposed compromise.